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# In the Supreme Court

OF THE

# United States

OCTOBER TERM, 1973

No. 73-331

CHARLES E. SALIK, DAVID SALIK, AND
MAURICE M. RICE

v.

UNITED CALIFORNIA BANK

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

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UNITED CALIFORNIA BANK

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

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Petitioners pray that a Writ of Certiorari issue to review an opinion and order of the United States Court of Appeals for the Ninth Circuit affirming the order of the United States District Court for the Southern District of California, which denied a Motion To Dismiss made by Petitioners on the ground that the applicable statute of limitations bars Respondent's alleged claim under Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5.

### OPINIONS BELOW

The opinion of the Court of Appeals, not yet officially reported, is set forth herein as Appendix A, *infra*, pp. 1a-5a. No formal opinion was issued by the District Court; its

Order Denying Motion To Dismiss is set forth herein as Appendix B, *infra*, pp. 6a-7a.

## JURISDICTION

The opinion and order of the Court of Appeals for the Ninth Circuit were entered on May 29, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

## QUESTIONS PRESENTED

**Conflict of Decisions in the Courts of Appeal.**

1. Should not the Ninth Circuit Court of Appeals, in selecting the state statute of limitations to be applied to actions brought under Section 10(b) and Rule 10b-5, look to the state substantive statute which most closely resembles Section 10(b) and Rule 10b-5 and which best effectuates the policies of the federal securities acts as have the Seventh and Eighth Circuit Courts of Appeal?

**Important Undecided Question of Federal Law.**

2. Should the consistently stated intent of Congress to have a one-year-from-discovery statute of limitations (with a three year cutoff) applicable to all express private causes of action for fraud under the federal securities acts compel the application of the same limitations period for implied private causes of action arising under Section 10(b) and Rule 10b-5, in order to end the chaos and conflicts which have resulted from the Courts of Appeal and the District Courts borrowing widely divergent state limitation provisions?

## STATUTES AND RULES INVOLVED

This case involves Section 10(b) of the Securities Exchange Act of 1934 (hereinafter "the 1934 Act"), 15 U.S.C. §78j(b), and Rule 10b-5 promulgated by the Secu-

rities and Exchange Commission (hereinafter "SEC"), 17 C.F.R. 240.10b-5, the California Corporate Securities Law of 1968, Cal. Corp. Code §§25401, 25501, and 25506 and California Code of Civil Procedure §338(4). Other statutes relevant to the issues raised in this case are Sections 27, 15 U.S.C. §78aa, and 29(b) of the 1934 Act, 15 U.S.C. §78cc(b), and Section 13 of the Securities Act of 1933 (hereinafter "the 1933 Act"), 15 U.S.C. §77m. All of these are reprinted in pertinent part in Appendix C, *infra*, pp. 8a-13a.

## STATEMENT OF CASE

### 1. Factual Background

In February 1969, Charles E. Salik, David Salik and Maurice M. Rice (hereinafter "Petitioners") accepted the offer of Respondent United California Bank (hereinafter "UCB") to purchase Petitioners' interests (a total of 40,000 shares of Class A stock) in the Salik Bank in Basel, A.G. (hereinafter "Salik Bank"), a Swiss corporation located in Basel, Switzerland. Pursuant to the terms of the Purchase Agreement executed on March 14, 1969, UCB's obligation to purchase the shares was subject to a number of express conditions precedent. These conditions required favorable opinions from independent experts selected by UCB as to the financial condition, corporate organization and validity of the shares of the Salik Bank, including an independent audit.

Thereafter, UCB, a multi-billion dollar international banking institution, undertook its own examination and verification of the Salik Bank's business, operating procedures and financial condition. The transaction closed on May 15, 1969, at which time UCB executed closing documents acknowledging that it was satisfied that the con-

ditions of the March 14 Agreement had been fulfilled. UCB then paid Petitioners $4,850,000 for all of Petitioners' stock in the Salik Bank. UCB also purchased shares of the Salik Bank from others, and as a result of these separate but contemporaneous transactions, it became the majority shareholder of the Bank which was then renamed United California Bank in Basel, A.G. (hereinafter "UCB-Basel").

As shareholders prior to the transaction, Petitioners, all citizens and permanent residents of the United States, had never taken an active part in the day-to-day management of the Salik Bank. After May 1969, Petitioners had no connection with UCB-Basel, either by way of stock ownership or otherwise.

In March, 1970, UCB effected a recapitalization of UCB-Basel through the sale by prospectus of more than $3,000,000 worth of shares to other investors at which time UCB itself purchased some $2,000,000 worth of shares in its Swiss subsidiary.

After UCB conducted an extensive investigation in August, 1970 of substantial losses incurred in prior months through commodity trading for the Bank's own account by UCB-Basel's management, UCB closed its Swiss subsidiary in September, 1970. At the same time UCB voluntarily paid or obligated itself to pay more than $42,000,000 to the creditors and depositors of UCB-Basel. In this action, UCB seeks general damages of $5,791,570 against Petitioners, the purchase price paid in May, 1969, for Petitioners' shares and additional shares from other persons.

**2. Proceedings Below**

On February 16, 1972, UCB filed a Complaint in the Southern District of California against Petitioners alleging two causes of action. Jurisdiction of the District Court

was invoked under Section 27 of the 1934 Act, 15 U.S.C. §78aa and under 28 U.S.C. §1331. The first cause of action alleges violation of Section 10(b) of the 1934 Act, and Rule 10b-5. The second cause of action alleges a state claim for breach of warranty and seeks to invoke the District Court's pendent jurisdiction.

The Complaint was filed some 18 months after UCB's discovery in August, 1970 of the losses incurred by UCB-Basel. Petitioners filed a Motion To Dismiss in the District Court, contending that UCB's claim for alleged violation of Section 10(b) and Rule 10b-5 was barred by the one-year-from-discovery statute of limitations found in both the 1934 Act and the California Corporate Securities Law of 1968, Cal. Corp. Code §25506 (hereinafter "California Securities Law") (Appendix C, *infra,* p. 12a).

Decisions in the Ninth Circuit prior to the 1968 enactment of the new California Securities Law had held that the applicable limitations period for Rule 10b-5 actions in California was the three-year-from-discovery (with no cut-off) period which governs common law fraud actions in California (hereinafter the "common law fraud statute of limitations") (Appendix C, *infra,* p. 13a). Neither the Ninth Circuit nor the Southern District of California had previously had the opportunity to choose between the common law fraud statute of limitations and the California Securities Law statute of limitations after the effective date (January 2, 1969) of the newer statute.[1] Petitioners

1. The State of California responded to recognized major defects in its old corporate securities law by the enactment of the comprehensive new California Securities Law of 1968, effective January 2, 1969, which closely resembles the 1934 Act and contains express remedies nearly identical to the implied cause of action under Section 10(b) and Rule 10b-5, *e.g.,* protecting buyers as well as sellers and covering mergers, market manipulations and trading with material inside information. See H. MARSH & R. VOLK, PRACTICE UNDER THE CALIFORNIA CORPORATE SECURITIES LAW OF 1968, 4-30 (1969).

argued that the California Securities Law, effective some five months prior to their transaction with UCB, best effectuated the policies of the federal securities acts and that the statute of limitations contained therein should be the one adopted under the prevailing "resemblance test" employed by the Seventh, Eighth and Ninth Circuits.

Petitioners also contended that an appropriate alternative to the selection of a California statute of limitations was to apply the one-year-from-discovery statute of limitations (with a three year cutoff) found throughout the federal securities acts,[2] specifically Section 29(b) of the 1934 Act (Appendix C, *infra*, pp. 9a-10a).

The District Court denied Petitioner's Motion To Dismiss on the ground that it was bound to apply the common law fraud statute of limitations. (Appendix B, *infra*, pp. 6a-7a). However, the District Court certified that a controlling question of law was involved and that an immediate interlocutory appeal would be appropriate. The Ninth Circuit then granted permission to appeal from the interlocutory order under 28 U.S.C. §1292(b).

On May 29, 1973, the Ninth Circuit affirmed the order of the District Court. In an opinion by Circuit Judge Wallace, the court summarily rejected the application of the one-

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2. Suits under Sections 11, 12(1) and 12(2) of the Securities Act of 1933, 15 U.S.C. §§77k, 77*l*(1) and 77*l*(2) are governed by the one-year-from-discovery, but not later than three years from the public offering or sale, limitations period of § 13 of that Act, 15 U.S.C. §77m. Suits under the express liability provisions of the 1934 Act, §§ 9(c), 18(c) and 29(b), 15 U.S.C. §§ 78i(c), 78r(c) and 78cc(b), are governed by similar one-year-from-discovery with three year cutoff limitation periods contained in those sections. The only deviation from this one-year-from-discovery and three year cutoff pattern is found in § 16(b) of the 1934 Act, 15 U.S.C. § 78p(b), which has a flat two year limitations period. See generally, Schulman, *Statutes of Limitation in 10b-5 Actions: Complication Added to Confusion*, 13 WAYNE L. REV. 635, 638 (1967).

year-from-discovery statutes of limitation consistently specified in the federal securities acts. Instead, the court invoked what it felt to be the appropriate local statute of limitations. In a choice between the one-year-from-discovery statute of limitations of the new California Securities Law and the three-year-from-discovery statute of limitations for common law fraud, the Ninth Circuit chose to adhere to its prior decisions that common law fraud statutes of limitation should govern 10b-5 actions, but conceded that its ruling conflicted with decisions of the Seventh and Eighth Circuits (Appendix A, *infra,* p. 5a, n. 7).

The Ninth Circuit chose to keep the common law fraud statute of limitations despite its express recognition that "the California legislature had enacted a statute of limitations for actions brought pursuant to a state statute similar to Section 10(b)." [Appendix A, *infra,* p. 3a, (emphasis added)] Without further discussion of this resemblance, the court held that the common law fraud statute of limitations should remain applicable because of certain policy reasons not heretofore recognized as part of the "resemblance test" or as bases for determining which local statute to borrow (Appendix A, *infra,* pp. 3a-4a).

In summary, the Ninth Circuit's decision in this case presents, on the undisputed facts, a direct conflict with recent decisions of the Seventh and Eighth Circuits on this identical legal issue. Also presented is the question of whether suits for alleged violations of Section 10(b) and Rule 10b-5 should be subject to the varying statutes of limitation borrowed from the states, or whether such suits should be uniformly governed by the one-year-from-discovery statute of limitations created by Congress for all express civil actions for securities fraud under the 1933 and 1934 Acts.

## REASONS FOR GRANTING THE WRIT

### I. THE NINTH CIRCUIT'S REJECTION OF THE "RESEMBLANCE TEST" HAS CREATED A DIRECT CONFLICT WITH RECENT DECISIONS OF THE SEVENTH AND EIGHTH CIRCUITS AS TO THE APPLICABLE STATE STATUTE OF LIMITATIONS FOR 10b-5 ACTIONS.

#### A. Federal Courts Have Consistently Utilized the "Resemblance Test" in Determining the Applicable State Statute of Limitations for Actions Under Section 10(b) and Rule 10b-5.

Neither Section 10(b) nor Rule 10b-5 contains a statute of limitations. Generally, in the absence of an applicable federal statute of limitations for a federal cause of action, this Court has directed that federal courts borrow the statute of limitations of the forum state which best effectuates the underlying policies of the federal legislation involved. This general rule is referred to as the "resemblance test." *International Union, United Auto Workers v. Hoosier Cardinal Corp.*, 383 U.S. 696, 703-705 (1966); *Cope v. Anderson*, 331 U.S. 461, 463-64 (1947); *Holmberg v. Ambrecht*, 327 U.S. 392, 395 (1946); *Campbell v. City of Haverhill*, 155 U.S. 610, 619-20 (1895). None of these cases, however, involved the federal securities acts.

The Circuits have applied the "resemblance test" to determine the appropriate statute of limitations to borrow for actions under Section 10(b) and Rule 10b-5, *i.e.*, to find the state statute of limitations "which best effectuates the federal policy at issue." *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123, 125 (7th Cir. 1972); *Douglass v. Glenn E. Hinton Inv., Inc.*, 440 F.2d 912, 915 (9th Cir. 1971); *Vanderboom v. Sexton*, 422 F.2d 1233, 1237 (8th Cir.), *cert. denied*, 400 U.S. 852 (1970); *Charney v. Thomas*, 372 F.2d 97, 100 (6th Cir. 1967).

The "resemblance test" in 10b-5 actions involves an initial interpretation of the substantive elements of proof required for a violation under Rule 10b-5 and thereafter a review of the statutes of limitations of the forum state to determine which among them best effectuates the federal policy of Rule 10b-5. In other words, as stated in *Lamb v. United Security Life Co.*, . . . . F.Supp. . . . . (S.D. Iowa Jan. 26, 1973), CCH FED. SEC. L. REP. ¶93,764 [1972-73 Transfer Binder], "the federal court [in 10b-5 actions] is required to apply the state statute of limitations applicable to like actions arising under the state law (citing *Hoosier Corp., supra; Campbell, supra;* and *Vanderboom, supra).*"

The Sixth and Eighth Circuits in *Charney, supra,* and *Vanderboom, supra,* respectively, applied the "resemblance test" but reached divergent results as to the applicable statute of limitations because of differing interpretations of the scope of Rule 10b-5. In *Charney,* the Sixth Circuit reluctantly applied the Michigan common law fraud statute of limitations, acknowledging that actions under Section 10(b) differed markedly from common law fraud actions, but noting that the Michigan Blue Sky Law had no provision similar to Section 10(b).[3]

Applying the "resemblance test," the Eighth Circuit in *Vanderboom* distinguished the holding of *Charney* on the basis of a different interpretation of the substantive elements of proof required for Rule 10b-5 and for common law fraud:

3. The court in *Charney* stated:

> Although in some cases the local Blue Sky Law might be the more appropriate point of reference, in the present case the Michigan law contains no provision similar to section 10(b) of the federal law. Thus, the normal six-year period of M.S.A. § 27A.5813 should apply despite the fact that the actions under section 10(b) are not exactly the same as common law fraud actions. [372 F.2d at 100 (emphasis added)]

> However, the present rule in the 8th Circuit is that Rule 10b-5 applies to negligent as well as intentional misrepresentations. [citation omitted] We therefore view the appellants' federal claim as a blue-sky type of implied statutory action rather than as a basic fraud action.
>
> * * *
>
> Thus, there is a clear distinction between the actions proceeding under federal Rule 10b-5 and actions proceeding under the Arkansas law of fraud in that the former is much more favorable to plaintiffs, eliminating several of the defenses available to defendants in a common law fraud action.
>
> * * *
>
> In light of the commonality of purpose and the lack of defenses available under both Rule 10b-5 and the Arkansas blue-sky law as compared with common law fraud in Arkansas, we agree with the District Court that the 2 year statute of limitations found in §22 of the Arkansas Securities Act of 1959 is the appropriate one to apply. [422 F.2d at 1238-40]

Following the Eighth Circuit's decision in *Vanderboom*, the Seventh Circuit in *Parrent v. Midwest Rug Mills, supra*, expressly adopted the "resemblance test" for 10b-5 cases as promulgated by the *Charney* and *Vanderboom* courts. The court in *Parrent* then followed the Eighth Circuit by holding that the statute of limitations provided by the Illinois Securities Law best effectuated the federal policy underlying the federal securities acts, and thus governed 10b-5 actions rather than the Illinois statute of limitations for common law fraud. *Parrent, supra*, 455 F.2d at 126-27.

The holding of the Ninth Circuit in the present case is in direct conflict with holdings of the Seventh and Eighth Circuits. In refusing to apply the "resemblance test," the Ninth Circuit employed what can best be characterized as a "locked-in test." The court chose to adhere to its

prior decisions applying the common law fraud statutes of limitation to 10b-5 actions, even though it acknowledged that the California Securities Law more closely resembled Rule 10b-5. Thus, the fashioning of the "locked-in test" to reach this result represents an abandonment of the "resemblance test" previously employed by the Ninth Circuit and other courts and relied upon by both plaintiffs and defendants in 10b-5 actions. That the "resemblance test" was actually rejected is undeniable in light of the Ninth Circuit's refusal to apply the California Securities Law despite its express recognition that it was similar to the provisions of Section 10(b). [Appendix A, *infra*, p. 3a]

Abandonment of the "resemblance test" by the Ninth Circuit portends even greater conflict among the Circuits. Prior to this decision, the Circuits were at least in general accord as to the test to be applied and the policies to be served in the choice and application of a state limitations period to a 10b-5 action.[4] Unless this conflict is resolved by this Court, each Circuit may devise independent tests and policies to decide this important federal question.

### B. The Seventh, Eighth and Ninth Circuits Have Uniformly Rejected the Requirement of Scienter in 10b-5 Actions, An Essential Element for Common Law Fraud, but the Ninth Circuit Ignored This Substantive Factor in Rejecting the "Resemblance Test."

The conflict between the Ninth Circuit and the Seventh and Eighth Circuits is even more significant when one

4. Borrowing a state limitations statute attempts to create a parity between local state and federal forums and expresses an important policy of federalism: deference to state jurisprudence when Congress has not legislated directly on the point. This policy compels deference by the federal courts to later changes in the state jurisprudence, especially when they are by well-considered legislation of broad applicability such as the California Corporate Securities Law of 1968.

considers the fact that all three Circuits have rejected the requirement of proving scienter in actions under Sections 10(b) and Rule 10b-5. *Ellis v. Carter*, 291 F.2d 270, 275 (9th Cir. 1961); *Myzel v. Fields*, 386 F.2d 718, 734-35 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968); *Parrent v. Midwest Rug Mills, Inc.*, 455 F.2d 123, 126 (7th Cir. 1972). The Seventh and Eighth Circuits weighed this factor heavily in determining that the appropriate statute of limitations was the one found in the state securities laws. They reasoned that violations under the state securities laws, like claims under Rule 10b-5, could be proved on the basis of negligent misrepresentation so that scienter was not required.[5]

The Ninth Circuit has previously held that scienter is not a substantive element of proof in 10b-5 actions. *Royal Air Properties, Inc. v. Smith*, 312 F.2d 210, 212 (9th Cir. 1962); *Ellis, supra*. On the other hand, the California courts require scienter as an essential element in common law fraud actions as do the state courts in Arkansas and Illinois. *Goldstein v. Enoch*, 248 Cal.App.2d 891, 895, 57 Cal. Rptr. 19 (1967); *Croley v. Baker*, 237 Ark. 136, 371 S.W.2d 830 (1963); *Dahlke v. Hawthorne, Lane & Co.*, 36 Ill.2d 241, 222 N.E.2d 465 (1966). However, the Ninth Circuit did not even discuss scienter in this case when it abandoned the "resemblance test," although the issue had been extensively briefed and argued. This creates a direct conflict with the other Circuits in a situation

5. Conversely, the Tenth Circuit in *Mitchell v. Texas Gulf Sulphur*, 446 F.2d 90, 104 (10th Cir. 1971), applied the Utah common law fraud statute of limitations to a 10b-5 action, noting that *Vanderboom* was "principally distinguishable because that circuit has abrogated any semblance of scienter in a private 10b-5 action." The opinion in *Mitchell* does not indicate that the court ever considered a state securities law limitations period for such actions.

presenting the identical legal issue based upon similar factual backgrounds.

### C. The Ninth Circuit's Decision to Borrow the State Statute of Limitations for Common Law Fraud Instead of the Statute of Limitations for Violations of the State Securities Law is in Direct Conflict with the Seventh and Eighth Circuits, and District Courts in other Circuits.

Numerous reported decisions in District Courts in other Circuits have adopted the "resemblance test" utilized by the Sixth, Seventh, and Eighth Circuits in *Charney, supra; Parrent, supra* and *Vanderboom, supra.* As a result, the clear majority of decisions on this issue now hold the appropriate state statute of limitations for 10b-5 actions to be the one specified in the state securities law, rather than the common law fraud limitations period.[6]

There are, however, other conflicting decisions on this question in addition to the Ninth Circuit's ruling in this case. [See the Table of Cases on pp. 19-20, *infra*] The conflict and confusion on this issue is most obvious within the Fifth Circuit where District Courts in Florida have

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6. First Circuit — *Dyer v. Eastern Trust & Banking Co.*, 336 F.Supp. 890, 905-906 (D.Me. 1971); Fourth Circuit — *Corey v. Bache & Co., Inc.*, 355 F.Supp. 1123, 1125-26 (S.D.W.Va. 1973); *Maine v. Leonard*, 353 F.Supp. 968, 970 (W.D.Va. 1973); *Batchelor v. Legg & Co.*, 52 F.R.D. 553, 558 (D.Md. 1971); Fifth Circuit — *Josef's of Palm Beach, Inc. v. Southern Inv. Co.*, 349 F.Supp. 1057, 1060 (S.D. Fla. 1972); *Richardson v. Salinas*, 336 F.Supp. 997, 1001 (N.D. Tex. 1972). In addition, district courts in the Seventh Circuit have uniformly followed the holding in *Parrent, supra. Kramer v. Loewi & Co., Inc.*, 357 F.Supp. 83, 85-87 (E.D. Wis. 1973); *Saemann v. Everest & Jennings, Int'l*, 343 F.Supp. 457, 460 (N.D. Ill. 1972).

reached opposite conclusions as to the appropriate state statute of limitations for 10b-5 actions.[7] Similar confusion exists in Texas where the Fifth Circuit and the Northern District of Texas, in separate cases, have applied different Texas statutes of limitation to 10b-5 actions.[8] These inconsistent results and the accompanying confusion demonstrate the necessity for this Court to resolve this important and recurring federal question. This Court must enunciate definitive standards to guide the federal courts in determining the appropriate state statute of limitations for 10b-5 actions, or, alternatively, resolve this question through the uniform application of the one-year-from-discovery limitations period consistently enacted by Congress for claims alleging securities fraud.

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7. In *Josef's of Palm Beach, Inc. v. Southern Inv. Co.*, 349 F.Supp. 1057, 1060 (S.D. Fla. 1972), the court selected the statute of limitations in the Florida Blue Sky Law for 10b-5 actions, specifically rejecting the state statute of limitations for common law fraud. Conversely, *Beefy Trail, Inc. v. Beefy King Int'l, Inc.*, 348 F. Supp. 799, 803-804 (M.D. Fla. 1972) holds that the Florida fraud limitations period governs a 10b-5 action, rather than the Blue Sky Law statute of limitations. See also, *Sargent v. Genesco, Inc.*, 352 F.Supp. 66, 76-77 (M.D. Fla., 1972), where the court considered the two Florida statutes of limitations and then applied a six year New York statute because the 10b-5 action had been transferred from New York pursuant to 28 U.S.C. §1404(a).

Virginia presents another example of conflicting District Court decisions in 10b-5 actions within the same state. In *Stevens v. Abbott, Proctor & Paine*, 288 F.Supp. 836, 844-45 (E.D. Va. 1968), the court applied the Virginia fraud statute of limitations to a 10b-5 claim, concluding that the Virginia Blue Sky Law did not cover "churning". However, the court in *Maine v. Leonard*, 353 F.Supp. 968, 970 (W.D. Va. 1973), applied the Blue Sky Law statute of limitations, specifically rejecting the fraud limitations period.

8. In *Aboussie v. Aboussie*, 441 F.2d 150, 156 (5th Cir. 1971), the Fifth Circuit applied the two-year Texas statute of limitations for fraud to a 10b-5 claim. Neither party challenged the applicability of that limitations period. However, in *Richardson v. Salinas*, 336 F.Supp. 997, 1001 (N.D. Tex. 1972), the court ruled that the applicable statute of limitations for 10b-5 actions in Texas was the limitations period contained in the Texas Blue Sky Law, not the common law fraud statute of limitations.

## II. THE PROPER STATUTE OF LIMITATIONS FOR PRIVATE SUITS UNDER RULE 10b-5 IS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH HAS RECEIVED DIVERSE AND INCONSISTENT TREATMENT AMONG THE CIRCUITS AND DISTRICT COURTS BY BORROWING FROM STATE LAWS. IT HAS NOT BEEN SETTLED BY THIS COURT, AND SHOULD BE, BY BORROWING FROM THE CONSISTENT CONGRESSIONAL PROVISIONS FOR ALL OTHER FEDERAL SECURITIES FRAUD CLAIMS.

### A. Borrowing State Limitation Periods For 10b-5 Actions Frustrates The Consistently Stated Intent of Congress and Contravenes Important Federal Policies.

Because of the consistently stated congressional intent to have a one-year-from-discovery statute of limitation (with a three-year cutoff) for all civil fraud actions contemplated under the federal securities acts,[9] it is neither appropriate nor efficient to borrow state statutes of limitation for 10b-5 actions.

Borrowing from state law serves a policy of creating parity between state and federal court actions on similar claims. But this policy is meaningful only so long as the actions are essentially local, and, unlike the instant case, the federal court borrows the appropriate local statute to maintain state-federal parity. When the actions are essentially national in scope, however, the objective of state-federal parity is insignificant in comparison to the need for national parity among the federal courts. Rule 10b-5 has created just such national actions, and requires the application of a uniform federal statute of limitations if the federal courts are to achieve consistent application of federal law under Rule 10b-5.

9. See Note 2, *supra*.

The past two decades have seen a number of decisions broadening the scope and availability of Rule 10b-5. This has resulted in a startling increase in the number of 10b-5 actions.[10] Rule 10b-5 has now emerged predominant among all remedies under the federal and state securities acts, not to mention many traditional corporate remedies. There is no sign that this trend will be reversed. In this age of pyramid sales schemes, franchising and real estate syndications, and the concomitant broadening of the definition of "security," it must be reasonably anticipated that Rule 10b-5 will at least maintain, and more likely strengthen, its dominant position in providing access to federal courts for claims involving alleged violations of securities laws.

It is significant, however, that the existence of a private right of action under 10b-5 was implied by the courts,[11] as opposed to the other private rights of action under the 1933 and 1934 Acts which were expressly created by Congress. In creating all the express liabilities for securities fraud under the 1933 and 1934 Acts, Congress enacted a one-year-from-discovery statute of limitations (with a three-year cutoff).[12] The application of various state statutes of limitation to 10b-5 actions is not the result of a purposeful congressional omission to speak on the subject. Rather it is a product of the judicial implication of a private right of action which Congress did not contemplate in any detailed way.

10. See 1 A. BROMBERG, SECURITIES LAW: FRAUD, Sec. 2.5(6), pp. 45-46 at notes 119-121 (1971). The 10b-5 explosion is discussed in *Sue, Sue, Sue: The Angry Stockholders,* 102 DUN'S 25-27, 73 (Aug. 1973), wherein the author notes that some 4,500 securities lawsuits have been filed in the last 2½ years in the federal courts.

11. *Kardon v. National Gypsum Co.,* 69 F.Supp. 512 (E.D. Pa. 1946) (seller's implied cause of action); *Fischman v. Raytheon Mfg. Co.,* 188 F.2d 783 (2d Cir. 1951) (buyer's implied cause of action). The existence of a civil remedy for violation of Rule 10b-5 is no longer subject to question. *Superintendent of Ins. v. Bankers Life & Cas. Co.,* 404 U.S. 6 (1971).

12. See Note 2, *supra.*

An implied civil action under Rule 10b-5 furthers the comprehensive scheme of federal securities regulation enacted by Congress, but this private right of action is only one part of the overall legislative scheme. An integral part of that original scheme of regulation is the one-year-from-discovery statute of limitations. However, the result of applying the "resemblance test", discussed *supra*, has been to thwart this part of the original congressional scheme, and many 10b-5 actions now have a longer limitations period than actions under the express remedy provisions for securities fraud. This makes Rule 10b-5 more attractive than the other remedies and has resulted in widespread abandonment by plaintiffs of the express remedies in an effort to plead a cause of action under Rule 10b-5.[13] But, as argued by Professor Schulman, this has not been accomplished without substantial harm to the entire federal scheme and to the development of Rule 10b-5:

> Reacting to this exodus, one judicial approach has been to create difficult elements of proof in 10b-5 cases in an apparent effort to achieve a rough equality between express and implied liability suitors, leaving behind a trail of unsatisfactory substantive law. On the other hand, a second line of cases has declined to create artificial counter-weights, thus opening the gates of 10b-5 with the result that the express liability sections have, for all practical purposes, been written out.
>
> The dilemma is serious. In much the same manner as Section 10b serves to fill in the gaps of the SEC's regulatory authority by permitting it to devise regulations to meet specific needs, the role of 10b-5 as a civil

13. In *Fershtman v. Schectman*, 450 F.2d 1357 (2d Cir. 1971), Chief Judge Friendly observed:

> This case represents another attempt to invoke the antifraud provisions of federal securities legislation and the SEC's Rule 10b-5 to confer federal jurisdiction in a situation to which the statutes and rule do not apply. [*Id.* at 1358]

> remedy should be to close any serious interstices in the scheme of express civil remedies. As an implied remedy, it should perform this role with minimum derogation of the requirements of the express liabilities sections. Yet the continuation of current law and mythology regarding the "advantages" of 10b-5 actions turns this problem into the above described unresolvable conundrum. . . .[14]

Professor Schulman's proposal for a uniform federal limitations period has been endorsed by Professor Loss who argues that 10b-5 actions should be governed by the one-year-from-discovery limitations period found in either § 29(b) of the 1934 Act, 15 U.S.C. § 78cc(b), or §13 of the 1933 Act, 15 U.S.C. § 77m.[15]

### B. Borrowing State Limitation Periods For 10b-5 Actions Produces Diverse Results and Encourages Forum Shopping.

The present statute of limitations doctrine for 10b-5 actions serves only to encourage forum shopping with the inevitable result of detracting from the "uniformity intended by the federal Securities Acts."[16] The obvious effect of borrowing from the forum state is to have 50 (or more) potential limitation periods for the same case, depending on where it is brought.[17] Adherence to the "resemblance test" is an inadequate solution to this problem since the resemblance must be selected from a multiplicity of statutes of one of the potential forum states.

Some state limitation statutes refer directly to fraud, some are for liability based on a statute, some are for debt

14. Schulman, *supra* Note 2 at 644-45.

15. VI L. Loss, SECURITIES REGULATION 3899-3900 (Supp. to Vol. III, 1969).

16. Schulman, *supra* Note 2 at 648.

17. For a discussion of this very problem in suits under the Labor Management Relations Act, see the dissenting opinion of Justice White, joined by Justices Douglas and Brennan, in *Hoosier Cardinal Corp., supra,* page 8, 383 U.S. at 711-712.

actions, and many are catch-alls for actions not specified in any other limitations provision. There are also Blue Sky Law limitations in nearly all states. Not only do the periods provided by the various statutes of limitation differ, but so also do the tolling provisions and the cutoff provisions, if any. The following table illustrates just some of the various types of state statutes of limitation of varying length which have been applied and rejected in 10b-5 actions:

| Case Name & Citation | Statute Selected | Length† (years) | Statute(s) Rejected | Length† (years) |
|---|---|---|---|---|
| First Circuit | | | | |
| *Collins v. Rukin*, 342 F. Supp. 1282 (D. Mass. 1972) | Mass. Blue Sky Law or general tort (dictum) | 2 | Section 13 of 1933 Act | 1 |
| *Dyer v. Eastern Trust & Banking Co.*, 336 F. Supp. 890 (D. Me. 1971) | Maine Blue Sky Law | 2††† | Actions on statutory liability | 6†† |
| Second Circuit | | | | |
| *Klein v. Shields & Co.*, 470 F. 2d 1344 (2d Cir. 1972) | New York fraud | 6 | None discussed | .. |
| Third Circuit | | | | |
| *Tober v. Charnita, Inc.*, 58 F.R.D. 74 (M. D. Pa. 1973) | Pa. personal trespass actions | 6††† | None discussed | .. |
| Fourth Circuit* | | | | |
| *Corey v. Bache & Co., Inc.*, 355 F. Supp. 1123 (S.D.W.Va. 1973) | Indiana Blue Sky Law** | 2†† | Indiana fraud | 6 |
| Fifth Circuit*** | | | | |
| *Azalea Meats, Inc., v. Muscat*, 386 F.2d 5 (5th Cir. 1967) | Florida fraud | 3 | Actions on statutory liability | 6†† |
| *Bailes v. Colonial Press, Inc.*, 444 F. 2d 1241 (5th Cir. 1971) | Alabama fraud | 1 | None discussed | .. |

| Case Names & Citation | Statute Selected | Length† (years) | Statute(s) Rejected | Length† (years) |
|---|---|---|---|---|
| *Dudley v. Southeastern Factor & Fin. Corp.*, 57 F.R.D. 177 (N.D. Ga. 1972) | Georgia fraud | 4††† | Georgia actions on statutory liability | 20†† |
| Sixth Circuit | | | | |
| *Denny v. Performance Systems, Inc.*, CCH Fed. Sec.L.Rep. ¶93387 (M. D. Tenn. 1971) | Tenn. fraud | 10 | Tenn. Blue Sky rescission actions | 1†† |
| Ninth Circuit | | | | |
| *Hoffert v. E. F. Hinkle & Co., Inc.*, 56 F.R.D. 395 (D. Ore. 1972) | Oregon fraud | 2 | Ore. Blue Sky; Actions on statutory liability | 3††<br>6††† |
| Tenth Circuit | | | | |
| *Geo. H. McFadden & Bro. Inc. v. Home-Stake Prod. Co.*, 295 F. Supp. 587 (N.D. Okla. 1968) | Okla. fraud | 2 | Okla. Blue Sky | 2†† |

* See Note 7, *supra*.

** Transferred pursuant to 28 U.S.C. § 1404(a).

*** See Notes 7 & 8, *supra*.

† From discovery unless otherwise indicated.

†† From the transaction.

††† From the transaction, but tolled until discovery by judicial decision.

This crazy quilt is simply unsuitable for what has come to be the most important civil remedial provision of the federal securities laws, Rule 10b-5.

### C. Using a Federal Limitations Period Is Appropriate For The Federal Cause Of Action Under Rule 10b-5.

The adoption of highly diverse state statutes of limitation for 10b-5 actions contradicts the specific congressional

intent manifested by the uniform statutes of limitation for express private remedies under the federal securities acts. Congress has spoken on this issue in regard to express remedies under the securities acts and its pronouncements should not be disregarded — in favor of only vaguely relevant state laws — merely because an implied right of action was created by judicial development.

The expressed federal policy of Section 10(b) and Rule 10b-5 is to protect both buyers and sellers of securities. *Clement A. Evans & Co. v. McAlpine,* 434 F.2d 100, 104 (5th Cir. 1970), *cert. denied,* 402 U.S. 988 (1971); *Ellis v. Carter,* 291 F.2d 270, 273 (9th Cir. 1961). Unnecessarily long limitations in 10b-5 actions serve to increase the danger that Rule 10b-5, with its easier burden of substantive proof, may become an insurance policy for disgruntled investors. Securities are distinct in several ways from most other subjects of fraud claims. They have no use value as compared to a defective product which can be repaired. Their value fluctuates — visibly in the case of an actively traded security — in response to management skill, business conditions, government financial policy and numerous other factors. With the tremendous potential for fluctuation in value in the securities market, it is inequitable to permit potential plaintiffs too long a period for asserting claims which might be based upon certain circumstances over which the original seller or buyer had no control. But the buyer is easily tempted to try to shift his loss to the seller by claiming fraud. This problem was recognized in *Royal Air Properties, Inc. v. Smith,* 312 F.2d 210 (9th Cir. 1962), where the court stated:

> The purpose of the Securities Exchange Act [of 1934] is to protect the innocent investor, not the one who loses his innocence and then waits to see how his

investment turns out before he decides to invoke the provisions of the Act. [*Id.* at 213-14]

Defendants in 10b-5 cases are often investors whose interests also deserve protection against the familiar problems of stale claims, missing or altered records, missing witnesses, dim recollections and subsequent mismanagement by controlling shareholders, considerations which are particularly apropos in this case. In *Burnett v. New York Cent. R.R.*, 380 U.S. 424 (1965), this Court declared:

> Statutes of limitations are primarily designed to assure fairness to defendants. Such statutes 'promote justice by preventing surprises through the revival of claims that have been allowed to slumber until evidence has been lost, memories have faded, and witnesses have disappeared. The theory is that even if one has a just claim, it is unjust not to put the adversary on notice to defend within the period of limitation and that the right to be free of stale claims in time comes to prevail over the right to prosecute them' [citation omitted] Moreover, the courts ought to be relieved of the burden of trying stale claims when a plaintiff has slept on his rights. [*Id.* at 428]

Considerations such as these led Congress itself to reduce the original statutes of limitation for express civil remedial actions found in the 1933 Act from two-year-from-discovery to one-year-from-discovery (and from a 10 year cutoff to a 3 year cutoff),[18] and to provide the same pattern for all express liabilities for securities fraud in the 1934 Act. Congress carefully balanced buyer-seller interests in setting the limitations pattern and this legislative intent should not be ignored.

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18. See III L. Loss, SECURITIES REGULATION 1743 (1961).

### D. In View of the Broad Venue Provisions of the 1934 Act, a Uniform Federal Statute of Limitations is Necessary to Prevent Forum Shopping for Longer State Limitation Periods Under the "Resemblance Test."

The 10b-5 limitations problem is compounded by the broad venue provisions of §27 of the 1934 Act, 15 U.S.C. §78aa, which permit a plaintiff to sue where (1) any act or transaction constituting the violation occurs, (2) defendant is found, (3) defendant is an inhabitant, or (4) defendant transacts business. This produces a very broad choice of forums for a plaintiff in a given case, *e.g.*, where the offering, negotiations, contract signing and closing occurs in different states, and a defendant is found, inhabits and transacts business in several other states. Direct borrowing of the forum limitations statute could offer plaintiff in this typical example numerous different limitations periods.[19] The worldwide service of process under §27 only reinforces plaintiff's broad choice of forum.[20] To the evils of forum shopping are added the evils of limitations shopping.

Another aspect of the forum shopping problem appears when the violation is a false prospectus, shareholder report, proxy statement or other publicity of a publicly held company. The misleading information is disseminated widely, and may produce lawsuits in 50 different states, probably class actions. But the choice of the proper limitations period

19. A similar hypothetical situation was raised in Justice White's dissenting opinion in *Hoosier Cardinal Corp., supra,* Note 17.

20. A more sophisticated conflicts rule, yet to be developed in this context, might still give plaintiff the choice of the limitations period of any state that had a substantial connection with the transaction.

raises complex questions which cannot be adequately answered through application of the "resemblance test."[21]

### E. The Broad Scope of Rule 10b-5 Combined with the "Resemblance Test" has Caused an Overburdening of the Federal Courts with Claims that are Barred in State Courts, Thereby Frustrating State Securities Legislation.

The liberal substantive elements of Rule 10b-5 have already attracted to the federal courts (given exclusive jurisdiction under §27 of the 1934 Act) a substantial volume of litigation which would traditionally have been in state courts on common law, Blue Sky or fiduciary principles. This is a form of forum shopping dictated by differences in substantive law. The combination of state borrowing, broad venue and securities peculiarities now attract older securities claims to federal courts under Rule 10b-5 with long local limitations. This results in unwarranted forum shopping based solely on accidents of state jurisprudence rather than on federal substance. The Ninth Circuit's decision in this case, if upheld, will promote this kind of forum shopping.

In the enactment of the federal securities acts, Congress was careful not to pre-empt the field of securities regulation.[22] However, the holding of the Ninth Circuit in the present case — rejecting the carefully considered one-year-from-discovery statute of limitations in the newer California Securities Law in favor of the old common law

21. For example: A plaintiff receiving and acting on false publicity in New York can now sue there as late as six years after the violation, but can he sue five years after discovery of the violation and represent a class which includes an Alabama resident who has only one year to sue under the law of that state?

22. See, *e.g.*, Section 28 of the 1934 Act, 15 U.S.C. §78bb, and Sections 16 and 18 of the 1933 Act, 15 U.S.C. §§ 77p and 77r.

fraud statute of limitations — frustrates the entire California statutory scheme. The incentive to the plaintiff now will be to use the federal forum with its potentially longer statute of limitations, especially in the context of a fluctuating securities market. This lack of deference to the legislative intent of the forum state results in a subversion of the state statutory scheme and an inevitable increase in potentially stale claims on the federal dockets. These claims, which should be litigated in a state forum,[23] result from the application of a statute of limitations which bears no relation to the realities of a 10b-5 claim. Unless eradicated by pronouncement by this Court, the forum shopping problem will serve only to further overload the federal system and undermine comity between the state and federal legal systems.

## CONCLUSION

Congress did not, nor did the courts or the SEC, intend that a comprehensive scheme of common law fraud would be developed by enactment of the federal securities acts. Why then borrow the longer state common law fraud stat-

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23. In *Ryan v. J. Walter Thompson Co.*, 453 F.2d 444 (2d Cir. 1971), *cert. denied*, 406 U.S. 907 (1972), the court noted with dismay the increasing number of attempts by plaintiffs to plead federal claims under Section 10(b) and Rule 10b-5, stating:

> This case is another example of a trend we have observed with disturbing frequency, namely, invocation of the salutary anti-fraud provisions of the federal securities laws in cases where those provisions are wholly inappropriate and wide of the Congressional mark. Moreover, the vice of this practice is compounded here by engrafting upon the misplaced federal securities law claim a state law claim that, but for the federal gloss, should have been litigated in the state courts. [*Id.* at 445]

Similarly, at the time of UCB's late commencement of this action, UCB was not barred from pursuing its alleged claim under California law for breach of warranty, or alternatively, common law fraud, in the California state courts.

utes of limitation? Why borrow any state statute of limitations when Congress has repeatedly and consistently exercised its judgment in favor of a one-year-from-discovery statute of limitations for federal claims alleging securities fraud?

The petition for a Writ of Certiorari should be granted to allow this Court to resolve the conflict among the Circuits on the important and recurring federal questions presented herein.

Respectfully submitted,

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# United States Court of Appeals

## *For The Ninth Circuit*

| | |
|---|---|
| UNITED CALIFORNIA BANK,<br>*Plaintiff-Appellee,*<br>*vs.*<br>CHARLES E. SALIK, *et al.*,<br>*Defendants-Appellants.* | No. 72-2140<br>Order<br>entered and<br>filed<br>May 29, 1973 |

**Appeal From the United States District Court**
**For the Southern District of California**

Before: HUFSTEDLER, TRASK and WALLACE, Circuit Judges

WALLACE, Circuit Judge:

Plaintiff-appellee, United California Bank (UCB), sued in district court alleging a violation of federal securities law and a claim for breach of warranty under state law. Defendants-appellants are residents of the United States and former shareholders of the Salik Bank in Basel, A.G., a corporation organized under the laws of Switzerland.

The complaint stated that UCB had purchased the defendants' shares of stock in May, 1969, pursuant to a previously-executed purchase agreement. UCB also alleged that after August, 1970, it learned that the Salik Bank (by then, UCB-Basel) had incurred, apparently prior to the sale, undisclosed losses of more than $40,000,000, primarily as a result of unauthorized trading in commodities. UCB claims that it was forced to discontinue operations at the Swiss bank, that UCB-Basel was insolvent and that it is now in the process of liquidation. UCB's complaint, filed February 16, 1972, attributed these results and its damages to the defendants' actions.

In the district court, the defendants moved to dismiss the complaint, arguing that the federal claim was barred by the statute of limitations' period specified in Cal. Corp. Code § 25506.[1] The trial judge denied the motion, holding instead that the applicable statute of limitation was found in Cal. Code Civ. P. § 338.[2] However, he certified that his order involved a controlling question of law and this court granted permission for an interlocutory appeal pursuant to 28 U.S.C. § 1292(b). We affirm.

UCB's federal claim alleges a violation of section 10(b)[3] of the Securities Exchange Act of 1934 (hereinafter Act) and rule 10b-5[4] promulgated thereunder. The Act does not contain a statute of limitation applicable to section 10(b) and federal courts have consistently rejected attempts to apply to section 10(b) other statutes of limitation found in the Act and in the Securities Act of 1933.[5] When, as in a case such as this, the statute is silent, we look to "an appropriate local law of limitations."[6]

In previous 10b-5 cases, we have applied the applicable state statute of limitations for fraud. Errion v. Connell, 236 F.2d 447, 455 (9th Cir. 1956); Fratt v. Robinson, 203 F.2d 627, 634 (9th Cir. 1953). Relying upon Errion and Fratt, we have adopted the California general fraud limitations period, Code Civ. P. § 338, for securities fraud cases arising in that state. Hecht v. Harris, Upham & Co., 430 F.2d 1202, 1210 (9th Cir. 1970); Sackett v. Beaman, 399 F.2d 884, 890 (9th Cir. 1968); Turner v. Lundquist, 377 F.2d 44, 46 (9th Cir. 1967).

However, in Douglass v. Glenn E. Hinton Investments, Inc., 440 F.2d 912 (9th Cir. 1971), we were faced with a choice between the Washington fraud statute adopted in Fratt and Errion, supra, and a special limitations statute for securities fraud enacted in the interim. We adhered to our selection of the former. 440 F.2d at 915-16.

Now we are again confronted by similar alternatives. Since the occurrence of the facts supporting the claims in Turner, Sackett and Hecht, supra, the California legislature has enacted a statute of limitations for actions brought pursuant to a state statute similar to section 10(b). The defendants urge this court to reject our previous decisions and to adopt the new statute, Cal. Corp. Code § 25506[7]. We decline to do so for several reasons.

First, as we noted in Douglass, supra:

> [F]or us to change the applicable limitation period because the local law of securities regulation has changed would add an unnecessary uncertainty to the prosecution of federal claims under section 10(b). We do not believe federal policy is advanced by changing the law governing the timeliness of federal claims to correspond with each change in the substantive elements of a claim under the local securities law. Aggrieved persons have come to rely upon our prior holdings. Reasonable stability in laws pertaining to voluntary relationships between parties, and the right of access to the courts to question those relationships, is a worthwhile objective as well.

440 F.2d at 916. Second, the broad remedial policies of the federal securities laws are best served by a longer, not a shorter, statute of limitation.[9] Under our prior rulings, a California resident may sue within three years of discovery of the fraud. Under the statute advanced, he would have only one year from discovery.

Finally, adoption of the new California statute would necessarily be piecemeal. The statute provides that a suit may be brought within one year of discovery of the violation but in no case more than four years after its occurrence. Federal policy provides that a statute of limitations shall not run until the fraud is, or should be, discovered.[10]

In the case of a fraud discovered more than three, but less than four, years after the occurrence, strict application of the California statute would afford only the balance of the fourth year within which to use. More importantly, a fraud discovered over four years after its occurrence would be completely barred.[11] To obviate this inconsistency with federal policy, we could judicially amend[12] the California statute by eliminating the four-year maximum. Alternatively, we could eliminate the one-year provision but amend the four-year provision to commence upon discovery. However, piecemeal adoption of the new statute is hardly preferable to continued utilization of the older fraud statute. Therefore, as in Douglass, we adhere to our prior decisions in Turner, Sackett and Hecht, supra, and hold that Code Civ. P. § 338 is the statute applicable to section 10(b) actions in California.

We recognize that there is no answer that is entirely satisfactory and we doubt any will be forthcoming unless Congress enacts a federal limitations statute specifically applicable to such actions.[13]

AFFIRMED.

United California Bank v. Salik, et al.
No. 72-2140

## FOOTNOTES

1. Section 25506 provides:

> No action shall be maintained to enforce any liability created under Section 25500, 25501, or 25502 (or Section 25504 insofar as it relates to those sections) unless brought before the expiration of four years after the act or transaction constituting the violation or the expiration of one year after the discovery by the plaintiff of the facts constituting the violation, whichever shall first expire.

Since UCB brought this action some eighteen months after the alleged discovery, application of § 25506 could conceivably bar its suit.

2. Section 338 provides in part:

Within three years:

* * *

4. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake.

The present action was probably timely under the provisions of this section.

3. 15 U.S.C. § 78j(b).

4. 17 C.F.R. § 240.10b-5.

5. 15 U.S.C. §§ 77a-aa. See, e.g., Douglass v. Glenn E. Hinton Investments, Inc., 440 F.2d 912, 914 (9th Cir. 1971); Janigan v. Taylor, 344 F.2d 781, 783 (1st Cir.), cert. denied, 382 U.S. 879 (1965).

6. Douglass, supra, 440 F.2d at 914. See Sackett v. Beaman, 399 F.2d 884, 890 (9th Cir. 1968). See also UAW v. Hoosier Cardinal Corp., 383 U.S. 696, 703-05 (1966); Holmberg v. Armbrecht, 327 U.S. 392, 395 (1946).

7. Faced with analogous choices, other circuits have recently chosen the securities statute of limitations rather than that of general fraud. See Parrent v. Midwest Rug Mills, Inc., 455 F.2d 123 (7th Cir. 1972); Vanderboom v. Sexton, 422 F.2d 1233 (8th Cir.), cert. denied, 400 U.S. 852 (1970). But see Charney v. Thomas, 372 F.2d 97 (6th Cir. 1967).

However, they have also determined that the adopted state statute shall only run in accordance with the federal law which decrees that the statute does not begin to run until the fraud is, or should be, discovered. Parrent, supra at 128; Vanderboom, supra at 1240. Accord Janigan v. Taylor, 344 F.2d 781 (1st Cir.), cert. denied, 382 U.S. 879 (1965). See also Holmberg v. Armbrecht, 327 U.S. 392 (1946); Bailey v. Glover, 88 U.S. (21 Wall.) 342 (1875).

8. See J. I. Case Co. v. Borak, 377 U.S. 426, 431-32 (1964); SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).

9. See Azalea Meats, Inc. v. Muscat, 386 F.2d 5, 8 (5th Cir. 1967); Beefy Trail, Inc. v. Beefy King Int'l, Inc., 348 F.Supp. 799, 803 (M.D. Fla. 1972).

10. See note 7, supra.

11. See note 1, supra.

12. See note 7, supra.

13. However, even if Congress is so disposed, it may wait until it receives The American Law Institute's proposed Federal Securities Code. Professor Louis Loss, the reporter for the project, currently estimates that the ALI Code will reach Congress in 1976 or 1977. Federal Securities Code, Introductory Memorandum at xv (Ten. Draft No. 2, 1973). Section 1421 of the draft contains proposed federal statutes of limitations for the remedies provided by the Code.

# United States District Court

## *Southern District of California*

| | |
|---|---|
| UNITED CALIFORNIA BANK, a California corporation, *Plaintiff,* v. CHARLES E. SALIK, DAVID SALIK AND MAURICE M. RICE, *Defendants.* | Civil No. 72-58-GT<br>ORDER DENYING MOTION TO DISMISS<br>Ordered entered on May 26, 1972 and filed May 30, 1972 |

This matter came on for hearing upon the defendants' motion to dismiss the complaint on May 9 and 12, 1972. O'Melveny & Meyers, by William W. Vaughn, appeared for the plaintiff, and Luce, Forward, Hamilton & Scripps, by Jack W. Crumley, appeared for the defendants.

The First Cause of Action of the complaint seeks damages for an alleged violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. § 240.10b-5. The Second Cause of Action invokes the pendent jurisdiction of this Court and seeks to recover for an alleged breach of warranty.

The defendants have moved to dismiss the complaint pursuant to Rule 12(b), F.R.C.P., alleging that the First Cause of Action is barred by the statute of limitations found in section 25506 of the California Corporations Code, or alternatively, section 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc. The defendants also request that the Court refuse to exercise its discretionary pendent jurisdiction and dismiss the Second Cause of Action.

Now having heard the arguments and having examined all the files, documents and records herein, and the Court

being fully advised in the premises, the Court has concluded that the motion to dismiss should be denied.

The Court is of the opinion that it is bound by both the rule and the reasoning of prior case law to apply the statute of limitations found in section 338(4) of the California Code of Civil Procedure to actions arising under section 10(b) and Rule 10b-5. Douglass v. Glenn E. Hinton Investments, Inc., 440 F.2d 912 (9th Cir. 1971); Smith v. Guaranty Service Corp., 51 F.R.D. 289 (N.D. Calif. 1970).

Since the breach of warranty claim in the Second Cause of Action arises out of the same transaction and involves the same facts as the First Cause of Action, the exercise of its pendent jurisdiction by the Court is appropriate.

Accordingly,

IT IS ORDERED that the defendants' motion to dismiss be and the same is hereby denied as to both Causes of Action.

GORDON THOMPSON, JR., *Judge*
*United States District Court*

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## SECURITIES EXCHANGE ACT OF 1934, SECTION 10(b)
## 15 U.S.C. § 78j(b)

**§ 78j. Manipulative and deceptive devices**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

• • •

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

## SECURITIES AND EXCHANGE COMMISSION RULE 10b-5
## 17 C.F.R. 240.10b-5

It shall be unlawful for any person directly, or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security. [SEC Sec. Exch. Act Rel. No. 3230]

## APPENDIX C

## SECURITIES EXCHANGE ACT OF 1934, SECTION 27
## 15 U.S.C. § 78aa

### § 78aa. Jurisdiction of offenses and suits

The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 225 and 347 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

## SECURITIES EXCHANGE ACT OF 1934, SECTION 29(b)
## 15 U.S.C. § 78cc(b)

### § 78cc. Validity of contracts

* * *

(b) Every contract made in violation of any provision of this chapter or of any rule or regulation thereunder, and every contract (including any contract for listing a

security on an exchange) heretofore or hereafter made, the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this chapter or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation: *Provided,* (A) That no contract shall be void by reason of this subsection because of any violation of any rule or regulation prescribed pursuant to paragraph (2) or (3) of subsection (c) of section 78o of this title, and (B) that no contract shall be deemed to be void by reason of this subsection in any action maintained in reliance upon this subsection, by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security in violation of any rule or regulation prescribed pursuant to paragraph (1) of subsection (c) of section 78o of this title, unless such action is brought within one year after the discovery that such sale or purchase involves such violation and within three years after such violation.

## SECURITIES ACT OF 1933, SECTION 13
## 15 U.S.C. § 77m

### § 77m. Limitation of actions

No action shall be maintained to enforce any liability created under section 77k or 77l(2) of this title unless brought within one year after the discovery of the untrue

statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence, or, if the action is to enforce a liability created under section 77l(1) of this title, unless brought within one year after the violation upon which it is based. In no event shall any such action be brought to enforce a liability created under section 77k or 77l(1) of this title more than three years after the security was bona fide offered to the public, or under section 77l(2) of this title more than three years after the sale.

### CALIFORNIA CORPORATIONS CODE § 25401

**§ 25401. Misrepresentation of Material Facts**

It is unlawful for any person to offer or sell a security in this state or buy or offer to buy a security in this state by means of any written or oral communication which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. Leg.H. 1968 ch. 88.

### CALIFORNIA CORPORATIONS CODE § 25501

**§ 25501. Rescission or Damages for Misrepresentation — Defenses**

Any person who violates Section 25401 shall be liable to the person who purchases a security from him or sells a security to him, who may sue either for rescission or for damages (if the plaintiff or the defendant, as the case may be, no longer owns the security), unless the defendant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know (or if he had exercised reasonable care would not have known) of the untruth or omission.

Upon rescission, a purchaser may recover the consideration paid for the security, plus interest at the legal rate, less the amount of any income received on the security, upon tender of the security. Upon rescission, a seller may recover the security, upon tender of the consideration paid for the security plus interest at the legal rate, less the amount of any income received by the defendant on the security. Damages recoverable under this section by a purchaser shall be an amount equal to the difference between (a) the price at which the security was bought plus interest at the legal rate from the date of purchase and (b) the value of the security at the time it was disposed of by the plaintiff plus the amount of any income received on the security by the plaintiff. Damages recoverable under this section by a seller shall be an amount equal to the difference between (1) the value of the security at the time of the filing of the complaint plus the amount of any income received by the defendant on the security and (2) the price at which the security was sold plus interest at the legal rate from the date of sale. Any tender specified in this section may be made at any time before entry of judgment. Leg.H. 1968 ch. 88.

## CALIFORNIA CORPORATIONS CODE § 25506

### § 25506. Time Limitations — Fraud Actions

No action shall be maintained to enforce any liability created under Section 25500, 25501, or 25502 (or Section 25504 insofar as it relates to those sections) unless brought before the expiration of four years after the act or transaction constituting the violation or the expiration of one year after the discovery by the plaintiff of the facts constituting the violation, whichever shall first expire. Leg.H. 1968 ch. 88.

## CALIFORNIA CODE OF CIVIL PROCEDURE § 338(4)

**§ 338. Three years; statutory liability, exception; trespass or injury to real estate; taking, detaining or injuring goods or chattels; fraud or mistake; bond of public official; notary public; additional time, maximum limit**

Within three years:

* * *

4. An action for relief on the ground of fraud or mistake. The cause of action in such case not to be deemed to have accrued until the discovery, by the aggrieved party, of the facts constituting the fraud or mistake.